

STATE OF IOWA  
PROPERTY ASSESSMENT APPEAL BOARD

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**CB Lodging, LLC,**

Appellant,

**v.**

**Pottawattamie County Board of Review,**

Appellee.

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**ORDER**

**Docket Nos. 11-78-0294 & 12-78-0701**

**Parcel No. 7444 03 351 002**

On October 22, 2013, the above captioned appeals came on for hearing before the Iowa Property Assessment Appeal Board under Iowa Code sections 441.37A(2)(a-b) and Iowa Administrative Code rules 701-71.21(1) et al. Attorney Richard Dvorak of Tomes & Dvorak, Overland Park, Kansas represented Appellant CB Lodging, LLC. Assistant County Attorney Leanne Gifford represented the Pottawattamie County Board of Review. The Appeal Board having reviewed the entire record, heard the testimony, and being fully advised, finds:

***Findings of Fact***

CB Lodging, LLC is the owner of a property located at 3216 Plaza View Drive, Council Bluffs, Iowa. The real estate was classified commercial on the January 1, 2011, assessment and valued at \$9,000,000. The assessment did not change for January 1, 2012.

CB Lodging protested both its 2011 and 2012 assessments to the Pottawattamie County Board of Review. For 2011, its protest was based on the grounds that the property was assessed for more than authorized by law under section 441.37(1)(a)(2); and there was a change downward in the value since the last assessment under sections 441.37(1)(b) and 441.35(2). It asserted the correct value was \$5,000,000. We note in a re-assessment year, a challenge based on downward change in value is akin

to a market value claim under section 441.37(1)(a)(2). *See Dedham Co-op. Ass'n v. Carroll County Bd. of Review*, 2006 WL 1750300 (Iowa Ct. App. 2006).

In 2012, CB Lodging again alleged the same grounds. Because the assessment did not change from the previous year, the only ground available to it was downward change in value. It asserted the correct 2012 assessment was \$4,950,000.

The Board of Review denied both protests.

CB Lodging then appealed to this Board reasserting its claims. It now contends the correct value for both years is \$7,000,000 based on an appraisal completed for January 1, 2011.

The property record card indicates the subject is a four-story hotel built in 2006. It has 86,141 gross square feet, 151 rooms, a swimming pool, two elevators, and 45,528 square feet of paving. The property carries the Marriott Spring Hill Suites flag. The site is 3.67 acres.

CB Lodging submitted an appraisal completed by Troy Smith of Veracity Valuation, LLC, Overland Park, Kansas. Smith also testified on CB Lodging's behalf. Smith's appraisal relied exclusively on the income approach to value. He concluded a value of \$7,000,000 for the subject property as of January 1, 2011.

Smith's appraisal states it only employs the Income Approach. He concluded the cost approach was not typically relied upon by investors for this type of property. He further states:

Despite the fact that the sale Comparison Approach would likely serve as a good complement [...], this approach is not particularly useful for ad valorem tax purposes. The comparable sales typically only provide an indication of the going-concern value, rather than a segregation of the going-concern value. Ad valorem valuation requires the segregation of only the land and improvements from the going-concern value. Thus, the scope of this appraisal has been limited to the most relevant indicator of value.

In Smith's opinion, the income approach is necessary and applicable for this type of property. We note, however, that the sales comparison approach is the required and preferred method of valuing property for tax assessment purposes in Iowa and it should be considered before moving to another approach to value. §§ 441.21(1)(b), (2).

During testimony, Smith attempted to assert that he considered sales and doing the sales approach but that there were no adequate sales available for analysis. Thus, he thought it would not prove reliable. Despite his testimony, we find it contradictory to the statements in his report and it affects his credibility. The text of his report also highlights his misunderstanding of Iowa law. We are not convinced Smith adequately supported his position that sales were lacking or that the sales comparison analysis would result in an unreliable analysis *before* he dismissed it. Other factors (income or cost approaches) may be considered only if the value cannot be readily determined using comparable sales. § 441.21(2). Regardless of Smith's shortcomings, we find other evidence in this case suggests the sales comparison approach alone is not a reliable indicator of value for the subject property.

Smith explained his first step in valuing the subject property was to estimate the income. He relied, in part, on a Smith Travel Research (STR) Star Report, dated January 1, 2011. (Exhibit 1 p. 23). The report provides historical information for the subject property, competing properties in the Omaha/Council Bluffs area, and other classes and sub-markets regarding the average daily rate (ADR), the average occupancy rate, and the resulting revenue per available room (RevPAR). He explained the RevPAR is the result of the average daily rate (the rate actually obtained) multiplied by the average occupancy rate. He considered this information when developing his income analysis. He estimated an ADR of \$90.00 and an occupancy rate of 60%. This results in total gross room revenue as follows:

151 rooms x 365 days x \$90.00 ADR x 60% Occupancy Rate = \$2,976,210 room revenue.

Smith then considered expenses. (Exhibit 1, pp. 29-30). He asserts the total gross income for 2008 was roughly \$3,915,000, but it decreased in 2009 by nearly \$1,000,000; and then increased, only ever so slightly, in 2010. In Smith's opinion, he believes buyers would have a more difficult time obtaining financing because of this history as it would increase their risk and lessen their desire to purchase this property. Ultimately, he concludes a net operating income (NOI) of \$1,013,522.

Next, he developed a capitalization rate. To do so, he considered the third quarter 2010 PriceWaterhouseCoopers (PWC) Real Estate Investors Survey, a national publication. (Exhibit 1 p. 31). Based on this source, which indicated a range of 8% to 12% for limited service hotels; he selected a 10% capitalization rate. He also considered “risk factors” of what a buyer would consider in determining his capitalization rate. The risk factors he considered included the difficulty of borrowing money as of the effective date; the subject’s diminishing income since 2008; the location of the subject property near interstate traffic, but not immediately visible or easily accessed; and that he believes the subject was over-built. Ultimately, he concluded a loaded capitalization rate (adjusted for real estate taxes) of 14.5%. Smith calculated the value of the subject by the income approach as follows:

$$\$1,013,522 \text{ NOI} / 0.145 \text{ capitalization rate} = \$6,989,806 \text{ (rounded to } \$7,000,000\text{)}.$$

We note Smith had a mathematical error in his reported NOI compared to his calculated results. We do not find the error significant and it does not affect the results.

CB Lodging also relied on the testimony of Charles E. Mackey, President of Capital Management, Inc. (CMI), a hotel development and management company. Mackey managed the subject property through CMI during the assessment periods in question, but he no longer manages the property. He provided background information regarding the subject property and his opinion of the market conditions as of January 2011. However, he did not offer an opinion of value. For this reason, we find his testimony has little value.

The Board of Review submitted an appraisal developed by Michael Olson of The Olson Group, Urbandale, Iowa. Olson developed all three approaches to value (cost, sales, and income) and arrived at a reconciled opinion of value of \$10,200,000, for the subject property as of January 1, 2011.

Olson first determined a value of \$10,750,000 based on the cost approach. (Exhibit A p. 60). We note this differs from his final reconciliation, where he indicates a value by the cost approach of \$11,150,000. (Exhibit A p. 98). We believe the latter is a typo. He testified that while he gave the

approach some consideration, his decision to develop the approach was as a “check” to the income and sales comparison approaches, to which he gave the most weight in his reconciled conclusion. The subject property was five years old as of the effective date. He notes the cost approach typically sets the upper end of the range; but he believes that because of the age of the property, an investor would expect the cost approach to be developed to determine whether buying or building would be less expensive.

Olson considered the income approach as the best indicator of value. He relied on data he had for the subject property, as well as market data such as the STR reports, to determine the income potential and expenses of the subject property. His analysis was similar to the analysis considered by Smith. Like Smith, Olson determined an ADR of \$90.00. However, while Smith had determined an occupancy rate of 60%, Olson concluded an occupancy rate of 65%. Olson explained the occupancy rate and capitalization rate were the primary differences between his income analysis and Smith’s. Olson believes that while allocations may have been slightly different between the two reports, overall the income and expenses were very similar.

CB Lodging questioned Olson on how he arrived at an ADR and was highly critical of the fact he did not include detailed information in his report. Olson explained he relied on properties that were in his report (Exhibit A, p. 65-70), as well as information from a STR report. CB Lodging noted Olson reported an ADR of \$93.15 for 2009 (Exhibit A p. 71), whereas, Smiths report indicates a 2009 ADR of \$92.73 (Exhibit 1 p. 26). This is a difference of \$0.42. CB Lodging asserts the difference is Olson’s mistake. Olson stated there could be a mistake in his or Smith’s report. Ultimately, the discrepancy is irrelevant as both appraisers used an ADR of \$90.00. We agree with CB Lodging that it would be helpful to have the sources cited with more specificity in Olson’s report, but his figures do not appear unreasonable.

Olson's occupancy analysis in his written report is limited. Olson's report indicates he chose an occupancy rate of 65% because the subject's short history supports that level. (Exhibit A p. 71). He further indicates the occupancy level for similar hotels was from 62.4% to 74.3%. (Exhibit A p. 71). Based on this brief statement, Olson concludes an occupancy level of 65%. Olson testified that only the subject and one other hotel are at 60% or below occupancy. In examining Smith's appraisal, we also note Smith stated the competitive set's occupancy rate was approximately 68% (this figure would be the mean of Olson's occupancy range). Yet, it appears Smith almost exclusively relied on the subject's actual 2011 occupancy rate of 59.8%. The occupancy rate difference between the Olson and Smith reports results in about a \$300,000 variance in the potential gross income (PGI) between the two reports. Given the market data offered by both Olson and Smith, we find Olson's occupancy rate to be more reflective of the overall market. This difference, together with the capitalization rate variance, produces the divergent results.

In determining the capitalization rate, Olson believes that while the market may not have been great in 2010-2011, the cost of money was a lot cheaper, which is a big component in the rate. He explained that he did not determine his capitalization rate based on sales in the market, not because of a lack of sales, but rather because he was unable to gather the income and expense information for those sales to extrapolate a capitalization rate. He considered risks involved in this type of property including future uncertainties and a lack of liquidity in real estate. He determined an overall rate of 8.57%, by the band of investment method. He believes this method is reliable; however, he also derived a rate using the debt coverage ratio as a check. Based on that analysis he concluded a rate of 7.89%. Lastly, he reviewed industry surveys, which indicated a direct capitalization rate for similar hotels has ranged from 8% to 10% nationally, with limited service hotels requiring higher rates. Considering all of this information, he concluded an overall capitalization rate of 9% and a loaded capitalization rate of 13.5%. This is in contrast to Smith's loaded rate of 14.5%.

CB Lodging was also critical of Olson's capitalization rate and questioned if Olson had considered the declining income of the subject property from 2008 to 2009. Olson answered he had considered this as a risk factor in the capitalization rate, but explained that this specific risk factor was not isolated and discussed in his report. He considered all risk factors that would impact the capitalization rate. Olson further explained he considered all of the subject's income, including the highest year of 2008. Whereas, he believes Smith considered only the worst years of the subject's income history and thus minimizes the first year of the subject's income. In reviewing the entire testimony and evidence, we find Olson developed his opinion of the capitalization rate using recognized methods. We further find his opinion to be reasonable.

Olson then calculated the value of the subject by the income approach as follows:

$\$1,507,000 \text{ NOI} / 0.135 \text{ capitalization rate} = \$11,162,962.96$  (rounded to \$11,150,000).

After deducting \$1,000,000 for furniture, fixtures, and equipment (FF&E) his total value indicated by the income approach is \$10,150,000.

Finally, Olson developed the sales comparison approach. He admitted it was difficult to find sales, but through websites and contacting local realtors, he was able to find a few. All three sales occurred in 2008. Olson's report states, "there are few, if any truly comparable sales of newly constructed hotels." (Exhibit A. p. 92). He adjusted the comparable properties to reflect date of sale, FF&E, location, and size. He does not believe Sale #3, located in downtown Omaha at 330 N 30th Street, is a good sale and gives it limited consideration in his analysis. He concludes a value of \$10,570,000 based on the sales approach. In his final reconciliation of the three approaches, Olson considers the income approach the best indicator of value and the sales approach was given some consideration as well. He considers the cost approach as a check for his conclusions.

Olson agrees the market has changed from 2008 to 2011. However, he believes to ignore the sales is nonsensical. Similarly, because the subject property is a newer property he believes the cost

approach would be relevant to an investor. Additionally, while he recognizes there was a downturn in market conditions in 2011, he believes the Midwest saw less impact than nationally.

### ***Conclusions of Law***

The Appeal Board applied the following law.

The Appeal Board has jurisdiction of this matter under Iowa Code sections 421.1A and 441.37A (2011). This Board is an agency and the provisions of the Administrative Procedure Act apply to it. Iowa Code § 17A.2(1). This appeal is a contested case. § 441.37A(1)(b). The Appeal Board determines anew all questions arising before the Board of Review related to the liability of the property to assessment or the assessed amount. § 441.37A(3)(a). The Appeal Board considers only those grounds presented to or considered by the Board of Review. § 441.37A(1)(b). But new or additional evidence may be introduced. *Id.* The Appeal Board considers the record as a whole and all of the evidence regardless of who introduced it. § 441.37A(3)(a); *see also Hy-vee, Inc. v. Employment Appeal Bd.*, 710 N.W.2d 1, 3 (Iowa 2005). There is no presumption that the assessed value is correct. § 441.37A(3)(a).

### ***General Principles of Law Applicable to Assessment of Real Property***

In Iowa, property is to be valued at its actual value. Iowa Code § 441.21(1)(a). Actual value is the property's fair and reasonable market value. *Id.* "Market value" essentially is defined as the value established in an arm's-length sale of the property. § 441.21(1)(b). Sale prices of the property or comparable properties in normal transactions are to be considered in arriving at market value. *Id.* If sales are not available, "other factors" may be considered in arriving at market value. § 441.21(2). The assessed value of the property "shall be one hundred percent of its actual value." § 441.21(1)(a).

### ***Grounds on Appeal***

In an appeal that alleges the property is assessed for more than the value authorized by law under Iowa Code section 441.37(1)(b), there must be evidence that the assessment is excessive and the



correct value of the property. *Boekeloo v. Bd. of Review of the City of Clinton*, 529 N.W.2d 275, 277 (Iowa 1995).

### ***Competency of Evidence and Comparables***

The sales-comparison method is the preferred method for valuing property under Iowa law. *Compiano v. Bd. of Review of Polk Cnty.*, 771 N.W.2d 392, 398 (Iowa 2009); *Soifer v. Floyd Cnty. Bd. of Review*, 759 N.W.2d 775, 779 (Iowa 2009); *Heritage Cablevision v. Bd. of Review of Mason City*, 457 N.W.2d 594, 597 (Iowa 1990). “[A]lternative methods to the comparable sales approach to valuation of property cannot be used when *adequate* evidence of comparable sales is available to *readily* establish market value by that method.” *Compiano*, 771 N.W.2d at 398 (emphasis added). “Thus, a witness must first establish that evidence of comparable sales was not available to establish market value under the comparable-sales approach before the other approaches to valuation become competent evidence in a tax assessment proceeding.” *Id.* (citing *Soifer*, 759 N.W.2d, at 782); *Carlton Co. v. Bd. of Review of Clinton*, 572 N.W.2d 146, 150 (Iowa 1997). The first step in this process is determining if *comparable* sales exist. *Soifer*, 759 N.W.2d at 783. To be comparable, the property must only be similar, not identical. *Bartlett & Co. Grain v. Bd. of Review*, 253 N.W.2d 86, 93 (Iowa 1977) (citing *Redfield v. Iowa State Highway Comm’n*, 99 N.W.2d 413, 418 (Iowa 1959)). If PAAB is not persuaded as to the comparability of the properties, then it “cannot consider the sales prices of those” properties. *Id.* at 782 (citing *Bartlett & Co. Grain Co. v. Bd. of Review of Sioux City*, 253 N.W.2d 86, 88 (Iowa 1977)).

Despite any attempt by CB Lodging to argue the contrary, the sales-comparison approach is a valid method, and the preferred method, for assessing commercial hotels under Iowa law. Although investors may be primarily interested in the income-producing potential of a property, it does not invalidate other methods of valuation or render Iowa law “obsolete,” as CB Lodging appears to assert. (Appellant’s Brief p. 6) (indicating the comparable sales approach set out in Iowa Code 441.21(1)(b)

“has perhaps become obsolete given the current industry standards and information desired by typically motivated buyers.”).

Generally, the burden of proof is on the taxpayer to prove one of the statutory grounds for protest by a preponderance of the evidence. § 441.21(3); *Compiano*, 771 N.W.2d at 396. However, if the taxpayer

offers competent evidence by at least two disinterested witnesses that the market value of the property is less than the market value determined by the assessor, the burden of proof thereafter shall be upon the officials or person seeking to uphold such valuation to be assessed. *Id.*

“Evidence is competent under the statute when it complies with the statutory scheme for property valuation for tax assessment purposes.” *Compiano*, 771 N.W.2d at 398. “[M]arket-value testimony by a taxpayer’s witnesses under a comparable-sales approach is ‘competent’ only if the properties upon which the witnesses based their opinions were comparable.” *Soifer*, 759 N.W.2d at 782.

In this case, Smith’s appraisal clearly indicates he did not complete the sales comparison approach to value. It further indicates his misunderstanding of Iowa law by stating that this approach is not typically used for ad valorem tax purposes. Contrary to his appraisal, Smith attempted to testify that he searched for sales but could not find any. He claimed to have limited this search to sales occurring from 2009 to 2011 because he believed any older sales were unusable because of the “economic recession.”

The Board of Review argues Smith’s appraisal is not competent evidence because he failed to establish that the property’s market value could not be readily established through the use of the comparable sales approach before moving to “other approaches” to value the property. As the Board of Review argues, Smith’s attempt to rehabilitate his appraisal through testimony is very similar to the witnesses in *Compiano*, 771 N.W.2d at 398. In that case, the real estate agent’s explanation for failing to use the sales comparison approach was that “potential buyers of [this type of] property prefer to

determine the sales price based on the income potential of the property.” *Id.* He looked for comparable sales but limited them to six months prior to the assessment date and the suburb where the subject property was located. *Id.* The Court determined this evidence was not competent. *Id.* Smith’s explanations for not doing the sales approach are much like those of the witness in *Compiano*. These facts cause us to question the competency of Smith’s evidence. It would appear, following *Compiano*, that it is not; however, rather than base our conclusion solely on this fact, we find additional reasons for not relying on Smith’s appraisal.

### ***Going-Concern***

In Iowa, assessors are permitted to consider the use of property as a going concern in its valuation. *Riso v. Pottawattamie Cnty. Bd. of Review*, 362 N.W.2d 513, 517 (Iowa 1985). When an assessor values property as a going concern, “he is merely following the rule that he must consider conditions as they are.” *Soifer*, 759 N.W.2d at 788 (quoting *Maytag Co. v. Partridge*, 210 N.W.2d 584, 590 (Iowa 1973)). The assessor is “recognizing the effect of the use upon the value of the property itself. He is not adding on separate items for good will, patents, or personnel.” *Id.*


Smith’s appraisal also draws into question his understanding of going-concern as he states the sales approach “is not particularly useful for ad valorem tax purpose” because it “only provide[s] an indication of the going-concern value, rather than a segregation of only the land and improvements from the going-concern value.” (Exhibit 1 p. 3). As previously noted, Iowa law is clear on this point, “property is valued based on its present use, including any functioning commercial enterprise on the property.” *Soifer*, 759 N.W.2d at 788. Despite Smith’s statement that would indicate he is valuing only “bricks and mortar” in a sales approach, which would have made it unreliable, it does not appear he actually subtracted any going concern value from his income approach. However, he tended to use the subject property’s actual occupancy and rates rather than examining the market as a whole as indication of value.

The evidence in the record as a whole clearly indicates the income approach is the best indicator in determining the subject's market value because comparable sales did not exist. Smith's evidence did not lead us to this conclusion, instead Olson's appraisal did. We remain unconvinced Smith moved to the income approach only after considering and establishing that the market value could not be readily established using the sales comparison approach

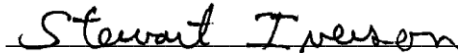
Unlike Smith, Olson developed and considered all three approaches to value. While Olson considered the income approach as his primary indicator of value, he also developed the sales comparison approach. Moreover, he completed a cost approach, which we believe is a reasonable approach to value given the subject property is relatively new. These two additional approaches lend support for his conclusions. Although Olson's appraisal does not contain detailed information regarding his sources, it appears Olson considered the market when valuing the property. For example, the two main areas of contention were the occupancy rate and capitalization rate. Specifically regarding the occupancy rate, Smith appears to use the subject property's actual occupancy at 60% compared to the market rate of 68%. Olson noted the occupancy levels, according to a study by STR, ranged from 62.4% to 74.3%. He concluded an occupancy rate of 65%, which is supported by the data. Finally, we note the Board of Review did not bear the burden of supporting the assessment as CB Lodging never shifted it. Even considering Smith's appraisal on its own, we cannot find it reasonably follows Iowa law and supports a conclusion that the subject property is over assessed.

THE APPEAL BOARD ORDERS the assessment of CB Lodging, LLC's property located at 3216 Plaza View Drive, Council Bluffs, Iowa, of \$9,000,000, as of January 1, 2011 and 2012, set by Pottawattamie County Board of Review, is affirmed.

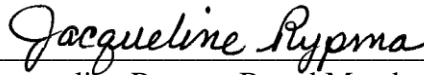
Dated this 23rd day of December, 2013.



Karen Oberman, Presiding Officer



Stewart Iverson, Board Chair



Jacqueline Rypma, Board Member

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